

CAMPBELL, ROYSTER, CARVER, McBRIDE & CO., LLP

CERTIFIED PUBLIC ACCOUNTANTS

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PUBLIC SERVICE
COMMISSION

February 7, 2004

Thomas M. Doorman
Executive Director
Public Service Commission
Post Office Box 615
Frankfort, KY 40602

RE: Case No. 1999-00388
Henderson County Water District

Dear Mr. Doorman:

As per your request in your letter dated January 27, 2004, I have enclosed my computation of the Henderson County Water District's debt service coverage. The computations are based on the audited financial statements for the year ended August 31, 2003, a copy of which is enclosed. The computation reflects a debt service coverage of 1.3311, which exceeds the required coverage of 1.3 required in the bond resolutions.

I apologize for the tardiness of this information, but it was simply overlooked by the superintendent of the District and me. If you have any questions or find you need additional information, please contact me at (207) 826-4474.

Sincerely,



Judson C. Royster, CPA

Enclosures (2)

cc: Alan VanMeter

**HENDERSON COUNTY WATER DISTRICT
COMPUTATION OF DEBT SERVICE COVERAGE
AS OF AUGUST 31, 2003
BASED ON AUDIT FINANCIAL STATEMENTS**

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Operating revenues:	
Water	\$ 1,850,676
Penalties and sundry	63,501
Total operating revenues	<u>1,914,177</u>
Operating expenses:	
Purchased water	686,055
Pumping utilities	24,877
Maintenance of system(schedule)	139,616
Vehicle and equipment(schedule)	23,618
Customer accounts (schedule)	89,346
Administration (schedule)	329,404
Depreciation and amortization	383,080
Total operating expenses	<u>1,675,996</u>
Operating income	<u>238,181</u>
Nonoperating revenues (expenses):	
Interest income	35,878
Gain (loss) on sale of equipment	409
Interest expense-refundable deposits, building loan and other	(3,160)
Interest expense - bonds	(311,158)
Interest expense-KIA debt	(28,758)
Loan service fees	(1,250)
Amortization of bond issue costs	(27,113)
Total nonoperating revenues (expenses)	<u>(335,152)</u>
Net income (loss)	<u>\$ (96,971)</u>
Debt service requirement-Bonds Only:	
Add back:	
Depreciation	\$ 383,080
Interest expense	311,158
Net revenues available	<u>597,267</u>
Maximum debt service	<u>\$ 448,698</u>
Coverage	<u>1.3311</u>

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HENDERSON COUNTY WATER DISTRICT

FINANCIAL STATEMENTS

Years Ended August 31, 2003 and 2002

HENDERSON COUNTY WATER DISTRICT
FINANCIAL STATEMENTS
Years Ended August 31, 2003 and 2002

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INDEPENDENT AUDITOR'S REPORT

To the Board of Commissioners
Henderson County Water District
Henderson, Kentucky 42420

We have audited the accompanying financial statements of Henderson County Water District, as of and for the years ended August 31, 2003 and 2002, as listed in the table of contents. These financial statements are the responsibility of Henderson County Water District, management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Henderson County Water District, as of August 31, 2003 and 2002, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 27, 2003, on our consideration of Henderson County Water District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The supplementary financial information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements of Henderson County Water District. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly presented in all material respects in relation to the financial statements taken as a whole.


Campbell, Royster, Carver, McBride & Co., LLP

October 27, 2003

HENDERSON COUNTY WATER DISTRICT

Balance Sheets

August 31, 2003 and 2002

	2003	2002
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 498,159	\$ 595,222
Investments, at cost	196,967	187,097
Accounts receivable (net of allowances for uncollectibles):		
Water	236,847	273,984
Other	828	802
Accrued interest receivable	4,669	10,205
Inventories	34,553	44,187
Prepaid expenses	28,268	19,212
Total current assets	1,000,291	1,130,709
Restricted assets:		
Cash and cash equivalents	601,550	929,650
Investments, at cost	489,847	669,844
Total restricted assets	1,091,397	1,599,494
Property, plant and equipment:		
Land	162,208	162,208
Buildings and improvements	611,034	611,034
Improvements other than buildings	12,837,753	12,540,566
Machinery and equipment	298,077	285,776
Office equipment	61,112	53,036
Construction in progress	670,917	34,467
	14,641,101	13,687,087
Less: accumulated depreciation	4,101,728	3,790,565
Net property, plant and equipment	10,539,373	9,896,522
Other assets:		
Other receivable	149,790	147,848
Unamortized bond discount and fees	176,429	160,704
Deferred charges, net	7,208	10,555
Total other assets	333,427	319,107
Total assets	\$ 12,964,488	\$ 12,945,832

	2003	2002
<u>LIABILITIES AND EQUITY</u>		
Liabilities:		
Current liabilities (payable from current assets):		
Current portion of notes payable	\$ 30,794	\$ 20,734
Accounts payable	81,779	88,241
Accrued liabilities	25,588	25,711
Customer deposits	41,815	40,820
Total current liabilities (payable from current assets)	179,976	175,506
Current liabilities (payable from restricted assets):		
Retainage payable	46,294	11,264
Contracts payable	139,887	----
Accrued interest	129,858	167,083
Current portion of notes payable	61,173	55,859
Current portion of revenue bonds payable	75,000	160,000
Total current liabilities (payable from restricted assets)	452,212	394,206
Long-term debt:		
Notes payable - net of current portion	533,041	591,162
Revenue bonds payable - net of current portion	5,154,185	5,557,158
Total long-term debt	5,687,226	6,148,320
Total liabilities	6,319,414	6,718,032
Equity:		
Contributed capital:		
Tap fees	1,481,888	1,411,763
Contributions in aid of construction	3,340,956	2,896,836
Total contributed capital	4,822,844	4,308,599
Retained earnings:		
Reserved for debt retirement	596,141	823,200
Unreserved	1,226,089	1,096,001
Total retained earnings	1,822,230	1,919,201
Total equity	6,645,074	6,227,800
Total liabilities and equity	\$ 12,964,488	\$ 12,945,832

HENDERSON COUNTY WATER DISTRICT
Statements of Revenues, Expenses and Retained Earnings
Years Ended August 31, 2003 and 2002

	2003	2002
Operating revenues:		
Water	\$ 1,850,676	\$ 1,845,635
Penalties and sundry	<u>63,501</u>	<u>61,191</u>
Total operating revenues	<u>1,914,177</u>	<u>1,906,826</u>
Operating expenses:		
Purchased water	686,055	627,124
Pumping utilities	24,877	20,694
Maintenance of system	139,616	160,934
Vehicle and equipment	23,618	26,944
Customer accounts	89,346	78,353
Administration	329,404	293,521
Depreciation	<u>383,080</u>	<u>373,123</u>
Total operating expenses	<u>1,675,996</u>	<u>1,580,693</u>
Operating income	<u>238,181</u>	<u>326,133</u>
Nonoperating revenues (expenses):		
Interest income	35,878	83,567
Gain on sale of assets	409	----
Interest expense - notes	(36,008)	(40,024)
Interest expense - bonds	(322,923)	(331,415)
Amortization of debt issue costs	<u>(12,508)</u>	<u>(12,621)</u>
Total nonoperating revenues (expenses)	<u>(335,152)</u>	<u>(300,493)</u>
Net income (loss)	(96,971)	25,640
Retained earnings, beginning of year	<u>1,919,201</u>	<u>1,893,561</u>
Retained earnings, end of year	<u>\$ 1,822,230</u>	<u>\$ 1,919,201</u>

HENDERSON COUNTY WATER DISTRICT
Statements of Cash Flows
Years Ended August 31, 2003 and 2002

	2003	2002
Cash flows from operating activities:		
Cash received from customers	\$ 1,887,813	\$ 1,809,146
Cash payments to suppliers for goods and services	(914,524)	(812,076)
Cash payments to employees for services	(394,182)	(381,360)
Other operating revenues	63,501	61,191
Net cash provided (used) by operating activities	642,608	676,901
Cash flows from noncapital financing activities:		
(Increase) decrease in deferred charges	(5,700)	9,047
Increase (decrease) in customer deposits	995	(4,574)
Net cash provided (used) by noncapital financing activities	(4,705)	4,473
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(860,541)	(332,585)
Proceeds from sale of assets	5,901	----
Tap fees	70,125	45,150
Contributed capital in aid of construction	444,120	333,450
Proceeds from issuance of revenue bonds and other capital notes	985,217	----
Bond discount and issuance costs	(34,622)	----
Principal paid on revenue bond maturities and other capital notes	(1,502,053)	(227,159)
Interest paid on revenue bonds and other capital notes	(380,786)	(359,835)
Net cash provided (used) by capital and related financing activities	(1,272,639)	(540,979)
Cash flows from investing activities:		
(Increase) decrease in other receivables	(1,968)	(3,161)
(Increase) decrease in investment securities	170,127	(74,954)
Interest income	41,414	86,885
Net cash provided (used) by investing activities	209,573	8,770
Net increase (decrease) in cash and cash equivalents	(425,163)	149,165
Cash and cash equivalents, beginning of year	1,524,872	1,375,707
Cash and cash equivalents, end of year	\$ 1,099,709	\$ 1,524,872

	2003	2002
Reconciliation of operating income to net cash provided (used) by operating activities:		
Operating income	\$ 238,181	\$ 326,133
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	383,080	373,123
(Increase) decrease in accounts receivable	37,137	(36,489)
(Increase) decrease in inventories	(149)	3,292
(Increase) decrease in prepaid expenses	(9,056)	(3,035)
Increase (decrease) in accounts payable	(6,462)	12,303
Increase (decrease) in accrued liabilities	(123)	1,574
Net cash provided (used) by operating activities	<u>\$ 642,608</u>	<u>\$ 676,901</u>

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Henderson County Water District ("Water District") was created by the fiscal court of Henderson County under the provisions authorized by Chapter 74 of the Kentucky Revised Statutes.

The accounting and reporting policies of the Water District conform to generally accepted accounting principles applicable to governmental units. Generally accepted accounting principles for governmental units include those principles prescribed by the Governmental Accounting Standards Board (GASB), the American Institute of Certified Public Accountants in the publication entitled Audits of State and Local Governmental Units and by the Financial Accounting Standards Board (FASB). As allowed in GASB's Codification of Governmental Accounting and Financial Reporting Standards, the Water District has elected not to apply to its proprietary activities Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins issued after November 30, 1989. The more significant accounting policies of the Water District are described below.

Reporting Entity

The financial statements of the Henderson County Water District include the funds comprising the primary government. In evaluating how to define the Water District for financial reporting purposes, management has considered any potential component units, based upon the Water District's ability to exercise significant oversight responsibility. Oversight responsibility was determined on the basis of the Water District's ability to significantly influence operations, select the governing body, participate in fiscal management and the scope of public service. Based upon the application of these criteria, no potential component units were noted.

Fund Types

A fund or account group is an accounting entity with a self-balancing set of accounts established to record the financial position and results of operations of a specific governmental activity. The Water District maintains the following fund type:

Proprietary Fund Type:

Proprietary Funds are accounted for on a flow of economic resources measurement focus. The accounting objectives are a determination of net income, financial position and changes in cash flow. All assets and liabilities associated with a proprietary fund's activities are included on its balance sheet. Proprietary fund equity is segregated into contributed capital and retained earnings.

Measurement Focus/Basis of Accounting

Measurement focus refers to what is being measured; basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement made, regardless of the measurement focus applied.

Proprietary fund types are accounted for on an economic resources measurement focus using the accrual basis of accounting. Revenues are recorded when they are earned, including unbilled water services which are accrued. Expenses are recorded at the time liabilities are incurred.

Inventories

Inventories are carried at the lower of cost (primarily first-in, first-out) or market.

Investments

Investments are carried at cost. Gains or losses are recognized when investments are sold or redeemed.

Donated Lines

From time to time prospective users have constructed and paid for line extensions and donated these additions to the Water District. These additions are recorded at cost invoiced to the user and are depreciated at rates based on their estimated useful life. Such additions are recorded as contributed capital.

Property, Plant and Equipment

Property, plant and equipment owned by proprietary funds are recorded at cost or, if contributed property, at their fair market value at the time of contribution. Repairs and maintenance are recorded as expenses; renewals and betterments are capitalized. Construction period interest is capitalized to property, plant and equipment.

Depreciation of all exhaustible fixed assets used by proprietary funds is charged as an expense against their operations. Accumulated depreciation is reported on proprietary fund balance sheets. Depreciation has been provided over the estimated useful lives using the straight-line method. The estimated useful lives are as follows:

Building and improvements	10-50
Improvements other than building	15-50
Machinery and equipment	5-10
Office equipment and fixtures	5-10

Tap Fees

Tap fees collected from new customers are recorded as contributed capital. The cost of installing the service lines and setting the water meters are capitalized and depreciated over their estimated useful lives.

Other Assets

Other assets subject to amortization include unamortized bond discount and fees, and deferred Public Service Commission ("PSC") rate case expenses. Unamortized bond discount and fees are being amortized on a straight-line basis over the life of the related debt. Deferred PSC rate case expenses are being amortized on a straight-line basis over a three year period, beginning with the date of the PSC rate order.

Accumulated Compensated Absences

Accumulated unpaid vacation amounts are accrued when incurred. The accrued compensated balance at August 31, 2003 and 2002 was \$11,432 and \$9,620, respectively.

Statement of Cash Flows

For the purposes of the Statement of Cash Flows, all highly liquid investments with a maturity of three months or less are considered to be cash equivalents.

Reclassifications

Certain accounts in the prior-year totals have been reclassified for comparative purposes to conform with the presentation in the current-year financial statements.

NOTE 2 - ALLOWANCE FOR UNCOLLECTIBLE ACCOUNTS

The allowance for uncollectible accounts receivable at August 31, 2003 and 2002 was \$24,596 and \$19,577, respectively.

NOTE 3 - CASH AND CASH EQUIVALENTS

Kentucky Revised Statutes authorize governmental units to invest in obligations of the United States and its agencies, obligations of the Commonwealth of Kentucky and its agencies, shares in savings and loan associates insured by federal agencies and deposits in national or state chartered banks insured by federal agencies and larger amounts in such institutions providing such banks pledge as security obligations of the United States government or its agencies.

At August 31, 2003, the Water District's demand and time deposits with the local custodial banks were fully covered by federal depository insurance or by pledged collateral held by the custodial banks in the Water District's name.

NOTE 4 - INVESTMENTS

Investments stated at cost consisted of the following at August 31, 2003 and 2002:

	<u>2003</u>	<u>2002</u>
Unrestricted:		
Certificates of deposit	\$ 196,967	\$ 187,097
Restricted:		
Certificates of deposit	<u>489,847</u>	<u>669,844</u>
	<u>\$ 686,814</u>	<u>\$ 856,941</u>

NOTE 5 - RISK MANAGEMENT

The Water District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Significant

losses are covered by commercial insurance for all major programs. There have been no significant reductions in insurance coverage and settlement amounts have not exceeded insurance coverage for the current year or the three prior years.

NOTE 6 - CHANGES IN PROPERTY, PLANT AND EQUIPMENT

A summary of changes in property, plant and equipment follows:

	Balance 8/31/2002	Additions	Disposals/ Transfers	Balance 8/31/2003
Land	\$ 162,208	\$ ----	\$ ----	\$ 162,208
Building and improvements	611,034	----	----	611,034
Improvements other than buildings	12,540,566	297,187	----	12,837,753
Machinery and equipment	285,776	89,710	77,409	298,077
Office equipment and fixtures	53,036	8,076	----	61,112
Construction in progress	34,467	636,450	----	670,917
	<u>\$ 13,687,087</u>	<u>\$ 1,031,423</u>	<u>\$ 77,409</u>	<u>\$ 14,641,101</u>

Construction commitments included in construction in progress are as follows:

	Project Auth.	Expended 8/31/2003	Committed
Water line extension project	\$ <u>1,117,803</u>	\$ <u>670,917</u>	\$ <u>446,886</u>

NOTE 7 - CHANGES IN LONG-TERM DEBT

The following is a summary of revenue bond and note transactions of the Water District for the year ended August 31, 2003:

	Notes Payable	Revenue Bonds	Totals
Bonds/notes payable-August 31, 2002	\$ 667,755	\$ 5,717,158	\$ 6,384,913
Bonds/notes issued	30,217	955,000	985,217
Bonds/notes retired	(77,053)	(1,425,000)	(1,502,053)
Increase in deferred valuation amount on debt refunding/restructuring	----	(29,739)	(29,739)
Amortization of deferred valuation amount on debt refunding/restructuring	<u>4,089</u>	<u>11,766</u>	<u>15,855</u>
Bonds/notes payable-August 31, 2003	<u>\$ 625,008</u>	<u>\$ 5,229,185</u>	<u>\$ 5,854,193</u>

On August 28, 2003, the Henderson County Water District issued \$955,000 Kentucky Rural Water Finance Corporation Public Projects Refunding Revenue Bonds Series 2003 B, interest ranging from 2.0% to 4.5%,

to advance refund outstanding 1993 Water Refunding Revenue Bonds and 1994 Water Refunding Revenue Bonds with outstanding balances of \$450,000 and \$815,000, respectively. \$401,333 of current debt service reserve and bond sinking funds were used toward the payoff of the 1993 and 1994 refunding revenue bonds. The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the 1993 and 1994 series bonds of \$110,815. This difference, reported in the accompanying financial statements as a deduction from bonds payable, will be charged to operations through the year 2014 using the effective-interest method.

On April 1, 1998, the Henderson County Water District executed a supplemental assistance agreement with the Kentucky Infrastructure Authority to restructure its existing loans to take advantage of lower market interest rates. The loan restructuring increased the outstanding principal balance by \$53,846. The loan restructuring costs are reported in the accompanying financial statements as a deduction from notes payable, and are being charged to operations (included in "interest expense") through the year 2011.

Bonds/notes payable at August 31, 2003 and 2002 are comprised of the following:

<u>Notes Payable:</u>	<u>2003</u>	<u>2002</u>
Note payable to Henderson County Fiscal Court, payable in annual installments of \$2,016 for 25 years, beginning in 1989; non-interest bearing	\$ 22,176	\$ 24,192
Note payable to Old National Bank, dated August 16, 2001, payable in monthly installments of \$1,131 including interest at 5.0%, through August 16, 2006, secured by real estate	37,655	48,995
Notes payable to Kentucky Infrastructure Authority, dated April 1, 1998, due in annual installments of \$46,825 to \$82,450 through June 1, 2011, interest payable semiannually on December 1 and June 1 at 4.75%	569,174	625,033
Note payable to Case Credit, dated May 28, 2000, payable in monthly installments of \$607 including interest at 6.5%, through May 28, 2003, secured by equipment	----	5,319
Note payable to Edgar County Bank & Trust dated July 30, 2003, payable in monthly installments of \$1,320 including interest at 4.96%, through June 30, 2005, secured by equipment	27,697	----
Deferred valuation amount on debt restructuring	(31,694)	(35,784)
	625,008	667,755
Less: current portion	91,967	76,593
	<u>\$ 533,041</u>	<u>\$ 591,162</u>

Revenue Bonds:

\$1,250,000 Water Refunding Revenue Bonds of 1993 dated March 1, 1993 due in annual installments of \$65,000 to \$120,000 through September 1, 2006, interest payable semiannually on March 1 and September 1, escalating from 3% to 5.75%	\$ ----	\$ 550,000
--	---------	------------

\$1,220,000 Water Refunding and Improvement Revenue Bonds dated January 1, 1994 due in annual installments of \$35,000 to \$90,000 through September 1, 2014, interest payable semiannually on March 1 and September 1, escalating from 4.5% to 5.2%	----	865,000
\$1,800,000 Water Revenue Bonds dated July 1, 1997 due in annual installments of \$5,000 to \$200,000 through September 1, 2022, interest payable semiannually on March 1 and September 1, escalating from 4.5% to 5.6%	1,770,000	1,775,000
\$2,625,000 Water Revenue Bonds dated June 1, 2000 due in annual installments of \$5,000 to \$330,000 through September 1, 2025, interest payable semiannually on March 1 and September 1, escalating from 5.1% to 5.75%	2,615,000	2,620,000
\$955,000 Public Projects Water Refunding Revenue Bonds dated August 15, 2003 due in annual installments of \$65,000 to \$100,000 through February 1, 2015, interest payable semiannually on February 1 and August 1, escalating from 2.0% to 4.5%	955,000	----
Deferred valuation amount on debt refunding	(110,815)	(92,842)
	5,229,185	5,717,158
Less: current portion	75,000	160,000
	<u>\$ 5,154,185</u>	<u>\$ 5,557,158</u>

The annual requirements to amortize all bonds/notes outstanding as of August 31, 2003, including interest payments of \$4,260,728 are as follows:

Year ending August 31	Notes Payable	Revenue Bonds	Total
2004	\$ 118,570	\$ 348,957	\$ 467,527
2005	115,959	363,302	479,261
2006	102,494	361,168	463,662
2007	88,788	358,745	447,533
2008	88,336	448,697	537,033
Thereafter	271,512	7,448,393	7,719,905
	<u>\$ 785,659</u>	<u>\$ 9,329,262</u>	<u>\$ 10,114,921</u>

There are a number of limitations and restrictions contained in the various bond indentures. The Water District is in compliance with all significant limitations and restrictions.

NOTE 8 - PENSION PLAN

A. Plan Description

The Henderson County Water District contributes to the County Employees Retirement System (CERS), a cost-sharing multiple-employer defined benefit pension plan administered by the

Kentucky Retirement System (KRS). CERS provides for retirement, disability and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living (COLA) adjustments are provided at the discretion of the State Legislature. Section 61.645 of the Kentucky Revised Statutes assigns the authority to administer the CERS to the KRS Board of Trustees. The KRS issues a publicly available financial report that includes financial statements and required supplementary information for CERS. That report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky 40601.

B. Funding Policy

Plan members are required to contribute 5.0% of their annual creditable compensation and the Water District is required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. The current rate is 6.34% of annual creditable compensation. The Water District's contributions to CERS for the years ending August 31, 2003, 2002, and 2001 were \$18,315, \$18,142, and \$18,758, respectively, equal to the required contributions for each year.

NOTE 9 - OTHER EMPLOYEE BENEFITS

Compensated Absences

All employees of the Water District earn and accrue vacation and sick time. The maximum number of vacation days that can be earned is twenty. Sick leave may be accumulated with a maximum of sixty-five days. An employee leaving for any reason, including retirement, will be paid their accumulated vacation. This liability is recorded in the financial statements.

Post Employment Benefits

In addition to the pension benefits described in Note 8, the Water District participates in the Kentucky Retirement Systems Insurance Fund (Fund). The Fund was created by the Kentucky General Assembly pursuant to the provisions of KRS 61.701 to provide hospital and medical insurance for members receiving benefits from the Kentucky Employees Retirement System, the County Employees Retirement System, and the State Police Retirement System (Systems). The Fund and members receiving benefits pay prescribed portions of the aggregate premiums paid by the Fund. For the year, insurance premiums withheld from benefit payments to members of the Systems approximated \$16,462,261 and \$355,816 for KERS and KERS hazardous, respectively, \$15,190,421 and \$1,299,220 for CERS and CERS hazardous, respectively, and \$285,755 for SPRS. The Fund pays the same proportion of hospital and medical insurance premiums for the spouse and dependents of retired hazardous members killed in the line of duty. As of June 30, 2002, the Fund had 58,020 retirees for whom benefits were available. The Fund's financial report is included in the KRS report whose address is listed in Note 8.

The amount of contribution paid by the Fund is based on years of service with the Systems. Years of service and respective percentages of the maximum contribution are as follows:

<u>Years of Service</u>	<u>Paid by Insurance Fund</u>	<u>Paid by Member</u>
20 or more	100%	0%
15-19	75%	25%
10-14	50%	50%
4-9	25%	75%
Less than 4	0%	100%

In prior years, the required medical insurance contribution rate was being increased annually by a percentage that would result in advance-funding the medical liability on an actuarially determined basis using the entry age normal cost method within a 20-year period measured from 1987. In November 1992, the Board of Trustees adopted a fixed percentage contribution rate and suspended future increases under the current medical premium funding policy until the next experience study could be performed.

In May 1996, the Board of Trustees adopted a policy to increase the insurance contribution rate by the amount needed to achieve the target rate for full entry age normal funding within twenty years. The increases commenced with the 1997 valuation and adjustments will be made every other valuation year to coincide with the valuation used by the General Assembly to establish employer contribution rates for the biennium.

NOTE 10 - KENTUCKY INFRASTRUCTURE AUTHORITY DEBT SERVICE RESERVE

The Debt Service Reserve (DSR) is a component of the Kentucky Infrastructure Authority (KIA) Fund C program. These are funds that are part of the Fund C borrowers' principal loan that is held by the KIA trustee bank when KIA bonds are issued. Each borrower in a bond issue is allocated their portion of DSR. The purpose of the DSR is to make debt service payments on the bonds if any of the borrowers in the entire Fund C pool default. Therefore, DSR funds are not guaranteed to be returned to the borrower in full. Interest is accrued to the borrower each June 30 and December 31 equal to the average rate of return on the three month treasury bill for the six months prior to calculation.

All debt service reserves are assets of the KIA and pledged to borrowers. It is the KIA board's policy to use DSR balances to make final payments on loans in the Fund C program, assuming no defaults by pool participants. The Water District's portion of the Fund C program DSR is recorded as an "Other receivable" classified under "Other assets" on the balance sheets as of August 31, 2003 and 2002.

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REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Board of Commissioners
Henderson County Water District
Henderson, Kentucky 42420

We have audited the financial statements of Henderson County Water District, as of and for the year ended August 31, 2003, and have issued our report thereon dated October 27, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Henderson County Water District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Henderson County Water District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgement, could adversely affect Henderson County Water District's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

Due to the relative small staff size, an overall lack of segregation of duties exist.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.

This report is intended solely for the information and use of management and Board of Commissioners, and is not intended to be and should not be used by anyone other than these specified parties.


Campbell, Royster, Carver, McBride & Co., LLP

October 27, 2003

HENDERSON COUNTY WATER DISTRICT
Schedule of System Maintenance, Customer Accounts
and Administrative Expenses
Years Ended August 31, 2003 and 2002

	2003	2002
<u>Maintenance of System:</u>		
Maintenance of mains	\$ 105,114	\$ 121,003
Materials & supplies - transmission	33,654	32,815
Materials & supplies - pumping	311	6,725
Rental - equipment	537	391
	<u>\$ 139,616</u>	<u>\$ 160,934</u>
<u>Customer accounts:</u>		
Salaries - meter reading	\$ 24,159	\$ 21,152
Billing and collections - labor and materials	60,144	55,862
Bad debts	5,018	1,339
Collection fees	25	---
	<u>\$ 89,346</u>	<u>\$ 78,353</u>
<u>Administration:</u>		
Salaries	\$ 64,787	\$ 62,037
Vacation and unassigned salaries	36,804	28,856
Commissioner's fees	8,400	9,520
Payroll taxes	21,790	21,508
Employee benefits	99,458	84,120
Office and computer expense	8,440	12,195
Telephone and utilities	10,049	8,760
Advertising	693	1,598
Professional fees	24,968	17,342
Insurance	28,965	24,534
Regulatory commission	12,607	13,131
Maintenance - office	5,798	5,955
Miscellaneous and general	6,645	3,965
	<u>\$ 329,404</u>	<u>\$ 293,521</u>

HENDERSON COUNTY WATER DISTRICT
Schedule of Insurance Coverage
Year Ended August 31, 2003

Fire and Extended Coverage

Water tank and pump house	\$1,770,000 - 90% Co-insurance
Office building and contents	

Comprehensive General Liability

Bodily injury	\$3,000,000 each occurrence
Property damage	\$3,000,000 each occurrence

Automobile Liability

Bodily injury	\$3,000,000 each occurrence
Property damage	\$3,000,000 each occurrence
Uninsured motorist	\$300,000 each occurrence

Flood

\$1,000,000

Earthquake

\$1,000,000

Workmen's Compensation

Statutory

Money and Securities

Employee dishonesty	\$10,000
Robbery inside/outside premises	\$2,500

Director and Officer Umbrella Liability

\$3,000,000

Commissioners and Employees are Bonded.